91-1254

Supreme Court, U.S.
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NO.

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1991

GEORGE JAMES PLATSIS, P.C.,

Petitioner,

v

E.F. HUTTON & COMPANY, INC. and
JOSEPH POTVIN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATE COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED

1. Is Rule 10b-5 violated as a matter of law whenever securities are sold to customers at prices that are excessive when compared to prevailing market prices for the securities?

2. May an appellate court substitute its own findings of fact for those of the District Court where there are two permissible views of the trial evidence?

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PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Petitioner respectfully prays that a writ of certiorari issue to review judgment and opinion of the United States Court of Appeals for the Sixth Circuit finally entered in this case on November 12, 1991. In the alternative, petitioner prays that this Court reinstate judgment of the United States District Court for the Western District of Michigan, the Honorable Wendell Miles, District Judge.

The Court of Appeals for the Sixth Circuit decided federal questions in a way which conflicts with decisions of this Court, in Anderson v Bessemer City, 470 Us 56, 573-576 (1984), S.E.C. v Capital Gains Research Bureau, Inc., 375 US 180 (1963), and Affiliated Ute Citizens v United States, 406 US 128 (1972).

Specifically, the Sixth Circuit made findings of fact that are contrary to the trial court record, contrary to FRCP 52(a) and this Court's holding in Anderson.

Further, the Sixth Circuit refused to apply the "shingle theory" of liability under Rule 10b-5, first announced in the case of Charles Hughes & Co. v S.E.C., 139 F2d 434, 437 (CA2 1943) and approved by this Court in Capital Gains.

OPINIONS BELOW

The opinions of the Court of Appeals for the Sixth Circuit are reprinted at appendix pages 1a-10a.

The decision of the United States district Court for the Western District of Michigan is reprinted at appendix pages 11a-70a.

STATEMENT OF JURISDICTION

A non-jury trial was concluded in the United States District Court for the Western District of Michigan and on April 18, 1990, the Honorable Wendell Miles filed Findings of Fact and Conclusions of Law, awarding George James Platsis, P.C. judgment in the amount of $38,000 plus interest. The Sixth Circuit Court of Appeals reversed. Jurisdiction of this Court to review the judgment of the Sixth Circuit is invoked under 28 USC Section 1254(1).

STATUTE AND RULE INVOLVED

This case involves Securities Exchange Commission Rule 10b-5, 17 CFR Section 240-10b-5, issued pursuant to Section 10b of the Securities Exchange Act of 1934, 15 USC Section 78j, which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or

instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or,

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security; and,

Federal Rules of Civil Procedure, Rule 52(a):

"In all actions tried upon the facts without a jury..., the court shall find the facts specially and state separately its conclusions of law thereon...Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses."

STATEMENT OF THE CASE

GEORGE JAMES PLATSIS, P.C. ("Corporation") brought suit against E.F. HUTTON AND COMPANY ("Hutton") and its salesman, JOSEPH POTVIN ("Potvin"), over the purchase of corporate utility bonds, alleging that defendants Hutton and Potvin charged excessive prices when compared to the prevailing market prices for the bonds and concealed the fact of such excessive markups from Corporation. 11a-15a.

Mr. Potvin recommended that Corporation purchase discount utility bonds on margin for an interest rate timing play and tax shelter purposes. Bonds issued at $1,000 face value and paying a coupon interest rate of around eight percent (8%) had depreciated in value to around $550 as interest rates rose to sixteen percent (16%), resulting in bond yields to maturity of sixteen percent (16%). The intent was to sell the bonds within six months to a year, when interest rates dropped, thus realizing capital gains that

would be taxed at a lower rate. 21a-29a.

The Corporation purchased 568 bonds from Hutton at a total cost of $351,400, about $620 for each bond. 23a.

The Honorable Wendell Miles found Corporation paid $38,000 more than the prevailing market for equivalent bonds. Footnote 14 at 63a-64a. At the time Corporation purchased its bonds from Hutton, the same bonds were selling in the market place at yields to maturity averaging sixteen percent (16%). However, at the prices Hutton charged Corporation for the bonds, yields to maturity averaged only fourteen percent (14%). Id.

The trial court also found that Hutton's charge of $38,000 above market price was concealed from the Corporation. Footnote 14 at 63a-64a, Footnote 10 at 60a-61a, Footnote 24 at 68a. Indeed, Potvin led Corporation to believe that its bonds were purchased at prevailing market prices, and that defendants did not profit from the transaction. 28a,

29a, Footnote 10 at 60a-61a.

The District Court further found that Hutton and Mr. Potvin intentionally concealed the $38,000 mark-up, in violation of Section 10b of the Securities Exchange Act of 1934, 15 USC Section 78j(b), Rule 10b-5, 17 CFR Section 240.10b5 and that defendants were guilty of common law fraud. 34a, I and K at 43a-45a.

The concealed markups of $38,000 comprised the spread between what Hutton or any other brokerage could have acquired the bonds for at the market, i.e. total of all bond "bid" prices at yields of sixteen percent (16%), and the higher "asked" prices Hutton actually charged Corporation for the bonds, which resulted in yields to maturity of only fourteen percent (14%). Footnote 14 at 63a-64a.

The Sixth Circuit Court of Appeals reversed the trial court, finding a lack of proof that there was any misrepresentation or omission of a material fact and that

Corporation failed to prove that Mr. Potvin acted with scienter.* 1a-10a.

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*The Appeals Court found scienter was not proven because Mr. Potvin lacked knowledge of how the bonds were priced. That fact alone was itself evidence of severe recklessness in the circumstances. Mr. Potvin knew the intended purpose of the investment, which depended upon purchases at the market. Indeed, Corporation sought the highest yields available (20a). Mr. Potvin had never used such bonds to time the market, and neither do experts (19a), precisely because utility bonds may have markups above market prices, that destroy any possible profits from a potential timing play. I at 43a. Without knowledge of the markups, Mr. Potvin had no basis upon which to recommend corporate bonds for timing purposes. Mr. Potvin recommended these bonds because he would earn more money in "production credits or commissions" than if he recommended U.S. Treasuries, which are used in timing plays, but have nominal markups. I at 43a. Findings at 21. Hutton and Mr. Potvin knew Corporation's investment strategy, but recklessly disregarded the fact that discount utility bonds are unsuitable for and incompatible with Corporation's timing strategy. Such severe recklessness is sufficient to establish scienter. Mansback v Ernst & Ernst, Ball & Turbin, 589 F2d 1017 (CA6 1976). "It is obvious that defendant must have been aware of...the present danger of misleading buyers." Ernst & Ernst v Hockfelder, 425 US 185, 193 (1975).

REASONS FOR GRANTING THE WRIT

DISCLOSURE OF BROKER-DEALER MARKUPS ON SECURITIES SOLD TO INVESTORS IS REQUIRED AS A MATTER OF LAW, WHERE THE BROKER-DEALER CHARGES PRICES ABOVE THE PREVAILING MARKET PRICE FOR THE SECURITIES AND THE BROKER-DEALER'S MARKUPS ARE EXCESSIVE WHEN COMPARED TO PREVAILING MARKET PRICE FOR THE SECURITIES.

Whenever a broker-dealer earns extra compensation as market maker above that earned in agency transactions, the duty of disclosure is enhanced because of an inherent conflict of interest. This principle is especially true of sales from the broker's inventory. All conflicts of interest in a securities transaction must be removed or completely disclosed. S.E.C. v Capital Gains Research Bureau, Inc., 375 US 181, 187-189, 196, 200, 201 (1963).

Here, the Sixth Circuit held that neither Hutton's "profit" nor charges above the prevailing market prices for the bonds, nor Mr. Potvin's large hidden commissions (production credits) earned as a consequence of his recommendation to purchase utility

bonds, nor the fact that excessive mark-ups from market prices were charged which severely limited any possibility for a timing play were subject to disclosure under Rule 10b-5. These factors could be omitted or concealed from the Corporation at the time of sale, even though the District Court clearly found that Hutton received $38,000 more than the prevailing market value of the bonds. Footnote 14 at 63a-64a.

However, whenever a broker-dealer purchases or sells securities at prices not reasonably related to prevailing market prices, either through excessive mark-downs from the market price in the case of purchases for its inventory, or through excessive mark-ups from the market in the case of sales to its customers, disclosure of the difference is required. Affiliated Ute Citizens v United States, 406 US 128 (1972): Staten Securities Corp., 47 S.E.C. 767, 768 (1980).

While a broker-dealer's profit on inventory sales can create a conflict of interest, and therefore disclosure of its status as market-maker or owner of the security is required, where the security is sold at prices above its market value, that difference or mark-up should also be disclosed. Broker-dealers can earn as much profit as their own efficiency permits, but when the price charged is not reasonably related to the prevailing market price of the security, that fact must be disclosed. Charles Hughes & Co. v S.E.C., 139 Fed 434, 437 (2d Cir. 1943), cert. denied, 321 US 786 (1944).

A buyer does not expect as a matter of course to buy securities at prices below the market. And, a buyer is not injured when securities are purchased at the market, provided any conflicts of interest have been revealed or removed. However, a buyer cannot be misled through a broker-dealer's silence into believing that the securities were

acquired at prevailing market prices when they were priced at substantial mark-ups from the market. A buyer should be able to decide whether to complete the transaction or take his business elsewhere.

Non-disclosure of mark-ups above prevailing market prices standing alone, regardless of conflicts of interest, statements made by the broker, investor sophistication, status of the parties or circumstances surrounding the sale of securities should constitute a violation of Rule 10b-5. Ettinger v Merrill Lynch Fenner Smith, 835 F2d 1031 (CA3 1987).

Charging excessive prices above prevailing market prices for the security is a per se violation of the Securities and Exchange Act.

> "Once that confidence was established, the failure to reveal the mark-up pocketed by the firm was both an omission to state a material fact and a fraudulent device. When nothing was said about market price, the natural implication in the untutored minds of the purchasers was that the

price asked was close to the market. The law of fraud knows no difference between express representation on the one hand and implied misrepresentation or concealment on the other." [Emphasis supplied] Charles Hughes & Co. at 437.

A. DISCLOSURE OF MARK-UPS REQUIRED WHERE PLAINTIFF'S BONDS WERE NOT PRICED IN ACCORDANCE WITH THE PREVAILING MARKET.

Federal securities laws mandate "'a high standard of business ethics'" for the securities industry. United States v Naftalin, 441 US 768, 775 (1979) quoting Capital Gains, supra, Bateman Eichler, Hill Richards v Berner, 472 US 299 (1985). Consistent with this high standard, the Securities and Exchange Commission (S.E.C.) and the courts have endorsed what has come to be known as the "shingle" theory, i.e., when a broker-dealer hangs out its professional shingle, it implicitly represents that it will deal with customers fairly, honestly and in accordance with industry standards. Charles Hughes.

Among the most basic of the implied representations attributed to a securities dealer is that when that firm sells a security to a customer, it will charge a price that is reasonably related to the prevailing market price of the security. Charles Hughes at 436-37. When a dealer marks up the price of a security so that the price charged is excessive when considered in relation to contemporaneous prices, and fails to disclose that fact, then the dealer violated the anti-fraud provisions of the federal securities laws. This type of fraud "is avoided only by charging a price which bears a reasonable relation to the prevailing price or disclosing such information as will permit the customer to make an informed judgment upon whether or not he will complete the transaction." [Emphasis supplied] In re Duker & Duker, 6 S.E.C. 386, 388-89 [describing fiduciary responsibilities of a broker];

B. FAILURE TO DISCLOSE EXCESSIVE MARK-UPS IS A PER SE VIOLATION OF RULE 10b-5

Hutton charged $38,000 above market for bonds it sold to Corporation for $351,000. That represents a charge of twelve percent (12%) above the prevailing market price ($351,000 - $38,000 = $314,000 dividend into $38,000 equals 12%).

The S.E.C. has adopted a rule that, while mark-ups on equities can be as much as five percent (5%) above market, mark-ups on debt securities should always be substantially less than five percent (5%). 52 Fed Reg 15, 575, April 19, 1987.

S.E.C. decisions and interpretive releases and the mark-up policy of the National Association of Securities Dealers (NASD) provide relevant guidance on whether Hutton's twelve percent (12%) mark-up is excessive.

The S.E.C. has consistently held that undisclosed mark-ups of more than ten percent

(10%) on debt securities are not only excessive but fraudulent as a matter of law. Staten Securities Corp., 47 S.E.C. 767, 768 (1980); [mark-ups of 5.1% to 6.7% on municipal bonds excessive]; In re DMR Securities, Inc., 47 S.E.C. 350, 352 (1980) [eight percent (8%) mark-ups fraudulent in the sale of municipal bonds, which should be considerably lower.]

Indeed, disclosure of excessive mark-ups does not justify charging excessive mark-ups. In re Amsbary, Allen & Morton, Inc., 42 S.E.C. 919, 922 N. 11 (1966).

The Sixth Circuit misconstrued Corporation's "shingle" theory of liability even though the District Court clearly found that Hutton priced Corporation's bonds at 12% above prevailing market prices.

The "shingle" theory announced in Charles Hughes & Co. was approved by this Court in Capital Gains Research Bureau, Inc. Under the "shingle" theory, misrepresentation and intent to defraud are

implied from the fact of excessiveness.

At the turn of the century, our common law recognized a specie of fraud based on mere non-disclosure of material facts. Strong v Repide, 213 US 419, 430 (1908). Concealment was considered the equivalent of misrepresentation with intent to deceive. Under this theory, fraud (misrepresentation and scienter) are presumed. Concealing the fact that securities were sold at prices that were excessive when compared to the market is sufficient to establish fraud. S.E.C. v Charles Morris & Assoc. Inc., 386 F Supp 1327, 1334-5 (1973).

> "[Courts have been] merging the proscription against non-disclosure into the general proscription against fraud, treating the former, in effect, as one variety of the latter." Capital Gains at 198.

The "shingle" theory rests on the principle that charging an excessive price is a "device, scheme or artifice to defraud" and "a practice, course of business which operates or would operate as a fraud or

deceit upon the purchaser." Exchange Act of 1934, Section 10b and Rule 10(b)5(a) and (c). The "shingle" theory does not rest on 10(b)5(b) alone, but on subsections (a) and (c) as well, which are designed to enforce a "high standard of business ethics." Bateman Eichler.

An investor's "reasonable expectation" of paying a commission is irrelevant if the investor purchased securities at prices not reasonably related to the prevailing market price for the securities. A broker-dealer's profit or loss on the sale of securities is also irrelevant.

Regardless whether Hutton bought Corporation's bonds above or below prevailing market prices and held the bonds at a loss for one hour, one month, or one year, Hutton was required to sell the bonds to the Corporation at prices reasonably related to prevailing market prices on the day and time of the actual sale to the Corporation. In re DMR Securities, Inc., 47 S.E.C. 180, 181,

182, (1979) [5 1/2% mark-up unfair, the price charged must be reasonably related to the current market price, regardless of the cost of a security to the broker-dealer.]

It is fraudulent to sell securities above the market price without disclosing the markup. This type of fraud is avoided only by charging a price which bears a reasonable relation to the prevailing price, or disclosing the markup and allowing the purchaser to determine whether to complete the purchase. Charles Hughes at 437.

To establish liability under the "shingle" theory, a court need answer only two questions: (1) were the bonds sold above market prices or was the markup concealed and (2) were the bonds sold at excessive prices when compared to the prevailing market?

The District Court clearly answered "yes" to the first question. Corporation paid too much--$38,000 more than the market price of the bonds. Footnote 14 at 63a-64a.

The District Court's answer to the first question answers the second. The overcharge of $38,000 represents 12% of the prevailing market price of the bonds.

Courts hold this percentage mark-up is excessive as a matter of law. Clark v John Lamula Investors, Inc., 583 F2d 594, 597 (1978).

CONCLUSION

The Sixth Circuit made findings of fact to reverse the District court. Its conduct is contrary to FRCP 52(a) and its own precedent announced in United States v Perry, 908 F2d 56 (CA6 1990) [reversal is not warranted if a district court findings are just, maybe or probably wrong; findings must strike the reviewing court as wrong with the force of a five-week-old unrefrigerated dead fish]. Moreover, the Sixth Circuit violated this Court's holding in Anderson v Bessemer

City, 470 US 564 (1984), [a reviewing court cannot duplicate the role of a lower court--if there are two permissible views of the evidence, the fact finder's choice between them cannot be clearly erroneous].

Further, liability under the "shingle" theory does not depend on express proof of a misrepresentation or omission and scienter. "The law of fraud knows no difference between expressed representation on the one hand and implied misrepresentation on the other." Charles Hughes at 437.

The business practices Hutton used against Corporation in this case violate Rule 10(b)5(a), (b) and (c), and the "high standard of business ethics" so eloquently described in Bateman Eichler and Capital Gains.

RELIEF

WHEREFORE, Petitioner George James Platsis, P.C. prays that this Honorable Court grant certiorari and review the judgment of the United States Court of Appeals for the Sixth Circuit.

ALTERNATIVELY, Petitioner prays this Honorable Court reinstate the judgment of the District Court of the Western District of Michigan for Plaintiff Corporation in the amount of $38,000.

Respectfully submitted,

January 31, 1992

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No. 90-1636/1678/1679
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

GEORGE JAMES PLATSIS, P.C., ET AL.,
Plaintiff-Appellant,

v.

E.F. HUTTON & COMPANY, INC.,
and JOSEPH POTVIN,
Defendants-Appellees.

BEFORE: JONES and RYAN, Circuit Judges; and
PECK, Senior Circuit Judge

The Court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members, but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER
OF THE COURT

November 21, 1991

Leonard Green, Clerk

RECOMMENDED FOR FULL TEXT PUBLICATION
Pursuant to Sixth Circuit Rule 24

Nos. 90-1636/1678/1679

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

GEORGE PLATSIS; GEORGE PLATSIS, P.C.,
Plaintiffs-Appellants, Cross-Appellees,

v.

E.F. HUTTON & CO., INC.; JOSEPH POTVIN,
Defendants-Appellees, Cross-Appellants.

ON APPEAL from the United States District Court for the Western District of Michigan

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Decided and Filed October 2, 1991

Before: JONES and RYAN, Circuit Judges; and PECK, Senior Circuit Judge.

JOHN W. PECK, Senior Circuit Judge. George Platsis, P.C., a legal professional corporation of which George Platsis was the sole employee and sole shareholder, received a contingency fee of $500,000 in 1980. Platsis consulted defendant Joseph Potvin of E.F. Hutton seeking investments which would allow him to maximize the after-tax return on the award. With Potvin's advice, Platsis invested $245,000 in oil and gas

partnerships. These investments were made immediately before the worldwide drop in oil prices. Consequently, Platsis lost more than half of the funds invested. Platsis sued E.F. Hutton alleging multiple securities law violations. The trial court found against Platsis on all counts, and this court affirmed in a per curiam opinion. 829 F.2d 13 (6th Cir. 1987).

In addition to the unsuccessful oil and gas investments, the Platsis corporation invested $351,400 in utility bonds. The bonds were recommended as a time-play device to reduce Platsis's income tax liability because the bonds had a low stated interest rate. Since interest rates were very high at the time the bonds were purchased, they were selling at a deep discount from their face value. E.F. Hutton predicted that market interest rates would fall, with the result that the purchase price of the utility bonds would increase while the taxable income from the bonds remained low. Additionally, the growth in value of the bonds would be taxed at capital gain rates as long as Platsis held the bonds longer than six months.

The utility bonds were transferred to Platsis as his salary on January 31, 1981, the last day of the corporation's tax year. In 1986, after the district court resolved the oil and gas suit in favor of defendant E.F. Hutton, Platsis and his corporation filed suit against both Hutton and Potvin asserting that the sale of the utility bonds violated state and federal securities laws and Michigan common law. Additionally, Platsis in his individual capacity sued Potvin in regard to the oil and gas investments.

The district court dismissed the oil and gas suit against Potvin on res judicata grounds and awarded Rule 11 sanctions against the plaintiff for bringing a duplicative lawsuit. The court also dismissed Platsis from the utility bond claims, holding that the corporation had standing to advance these claims but the individual did not. The remaining claims, the corporation's claims regarding the utility bonds, were tried before the district court. The

court found for the plaintiff corporation and awarded it $38,000 in damages, plus pre- and post-judgment interest.

Platsis has appealed the dismissal of his oil and gas suit against Potvin and the award of Rule 11 sanctions. He also appeals the court's decision that he lacked standing to join the utility bond suit. Platsis's corporation appeals the court's failure to award interest as damages and other exemplary damages. The defendants cross-appeal the $38,000 award. For the reasons that follow, We Reverse the district court's finding in favor of the plaintiff on the utility bond claim, and We Affirm the judgment of the district court in all other respects.

I. FACTS

Of the $351,400 in utility bonds purchased by the corporation, less than $50,000 worth were bought on the New York Bond Exchange. The remaining bonds were purchased from E.F. Hutton's inventory. The bonds were bought during the last twelve days of 1980 with some of the settlement dates falling in January 1981. Platsis received purchase confirmation slips for each of the sixteen bond purchases. The slips for the Exchange bonds reflected commissions and showed that E.F. Hutton was acting as an agent. Those for the inventory bonds did not include commissions and showed that E.F. Hutton was acting as a principal/market maker. At some point before all of the bonds were settled, Platsis asked Potvin why some of the confirmation slips did not show commissions. Potvin explained that those purchases were from inventory and the brokerage did not charge commissions on inventory transactions. This statement was true. However, the trial court found that it was designed to, and did, deceive Platsis into believing that E.F. Hutton did not profit from inventory transactions. The court found that both Hutton and Potvin profited from the inventory sales, and found that the failure to explain this to Platsis, especially in light of his question regarding commissions, was a material omission in the face of a duty to disclose, and consequently violated Rule 10b-5.

II. DISCUSSION

A. Non-disclosure of Profits

In order to establish a violation of Rule 10b-5, the plaintiff must show:

> (1) a misrepresentation or other fraudulent device; (2) a purchase or sale of securities in connection with the fraudulent device; (3) scienter by defendant in making the misrepresentation or omission; (4) materiality of the misrepresentation or omission; (5) justifiable reliance on the fraudulent device by plaintiff (or due diligence against it); and (6) damages resulting from the fraudulent device.

Shivagni v. Dean Witter Reynolds, Inc., 825 F.2d 885, 888 n.6 (5th Cir. 1987).

The trial court held that Potvin's failure to disclose the amount of the production credits and markups earned on inventory sales was a deliberate, material omission in the face of a duty to disclose. We find that the trial court's finding that the omission was deliberate was clearly erroneous, and we therefore reverse.

Scienter is a necessary element of a 10b-5 claim. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1975). To establish this element, the plaintiff must show that the defendant acted:

> with 'actual intent to deceive, manipulate, or defraud' or severe recklessness, which is 'limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been

aware of it.'

Shivagni, 825 F.2d at 889 (quoting *Ernst & Ernst*, *supra*, and *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961-62 (5th Cir.) (en banc), *cert. denied*, 454 U.S. 965 (1981)).

The district court made a number of factual findings with regard to the transaction at issue. First, the court found that very few brokers disclosed production credits, spreads or markups in 1980. Additionally, the court found that the markups and credits were reasonable. The court found that Potvin did not know the amount of the spreads which Hutton charged for the bonds that plaintiff purchased, although he was familiar with Hutton's usual spreads. Moreover, the court found that the plaintiff presented himself as a sophisticated investor. Platsis' background suggests that he is more sophisticated than the average investor: he graduated from University of Michigan law school, worked for the Federal Trade Commission for two years and later worked for the consumer fraud division of the Michigan Attorney General's Office. Moreover, the trial court found that Platsis conveyed the impression that he was more sophisticated in investment matters than he actually was. In fact, Platsis held himself out to E.F. Hutton as an investment advisor handling the investment decisions for one of his clients. The court further found, based on Platsis' own testimony, that when Platsis made the decision to invest in utility bonds he expected the defendants to make a profit on the transactions.

From these facts, we conclude that the district court clearly erred in finding that defendants acted with scienter. Since very few brokers disclosed these credits at the time these events took place and there was no established regulatory duty to disclose these items, an intent to deceive or an "extreme departure from the standards of ordinary care" could not be established merely by the omission of this information in the absence of special circumstances. We find that there were no special circumstances in this case that converted an

innocent silence into one of deceit.

The district court found scienter because when Platsis asked why some of the transactions did not reflect commissions, Potvin responded that commissions were not charged on inventory sales without further explaining what compensation was earned through those transactions. We cannot agree that this question provoked a duty to disclose the defendants' compensation system. Potvin first met with Platsis in October of 1980 and met with him several times over the subsequent two months to develop an investment strategy. During this time, Platsis presented himself as a sophisticated investor. Furthermore, Platsis had approved the investment strategy, apparently with no inquiries regarding the source of the bonds or the defendants' compensation, leaving only the actual purchases of the securities to be completed. Under these circumstances, we find that Potvin's failure to respond to Platsis' question with an in-depth discussion of the compensation system for inventory transactions was not deceptive.

Accordingly, we reverse the district court's finding of a 10b-5 violation. Because a claim for actual fraud under Michigan law also requires a finding of scienter, *In Re Estate of Swantek*, 172 Mich. App. 509, 432 N.W.2d 307, 310, *appeal denied*, 432 Mich. 874 (1989), we reverse that finding as well.

Additionally, we find that the district court erred as a matter of law in concluding that plaintiff had established a claim of innocent misrepresentation. Michigan's law of innocent misrepresentation is stated as follows:

> where an action is brought to recover for false and fraudulent misrepresentations made by one party to another [1] in a transaction between them, [2] any representations which are false in fact [3] and actually deceive the other, and [4] are relied on by him to his damage are actionable, irrespective of whether the person making them acted in good

> faith in making them, [5] where the loss of the party deceived inures to the benefit of the other.

U.S. Fidelity & Guaranty v. Black, 412 Mich. 99, 116 (1981).

Although an innocent misrepresentation claim does not require scienter, it does require a representation which is false in fact. This element can be satisfied only by an affirmative misstatement, not by an omission. *Dix v. American Bankers Life Assur. Co. of Fla.*, 141 Mich. App. 650, 367 N.W.2d 896, 900 (1985), *aff'd in part, reversed in part on other grounds*, 429 Mich. 410, 415 N.W.2d 206 (1987). *See also General Electric Corp. v. Wolverine Ins. Co.*, 420 Mich. 176, 362 N.W.2d 595, 600 (1984) (misrepresentation is "an assertion which is not in accord with the facts"). Since nothing in the record suggests that Potvin was guilty of any affirmative misstatement, the district court's conclusion that the defendants were liable for innocent misrepresentation under Michigan law was erroneous and must be reversed.

Finally, because we find that the defendants' conduct did not violate Rule 10b-5, we need not address Platsis' claim that he had standing as an individual to pursue this suit or the corporation's claim that the court should have awarded additional interest and exemplary damages.

B. Suitability Claim

Plaintiff's expert, Mr. Stasen, testified at trial that utility bonds were an inappropriate investment for plaintiff's stated objective. Instead, he concluded that the only appropriate investment would have been municipal bonds. Therefore, the plaintiff contends that the trial court should have awarded plaintiff the difference between the cost of municipal bonds and what he paid for the utility bonds. The trial court determined that these allegations were not pleaded and therefore could not be argued at trial.

Unsuitability claims "are essentially fraud claims and must be pleaded with particularity." *Craighead v. E.F. Hutton*, 899 F.2d 485, 493 (6th Cir. 1990). Our review of the record shows that neither the initial complaint nor either of the amended complaints contained any allegation that the utility bonds were unsuitable for the corporation's investment purposes. Accordingly, we conclude that the district court did not err in refusing to consider these allegations.

C. Res Judicata

Platsis asserts that this court should reverse the district court's dismissal of his oil and gas claims on res judicata grounds. First, Platsis asserts that he was prejudiced by defendant Potvin's failure to follow the proper procedures for asserting res judicata. Plaintiff asserts that res judicata is an affirmative defense, and that it must be raised in the answer, not in a motion to dismiss. Additionally, plaintiff contends that in order to prevail on a res judicata theory, the defendants must attach affidavits regarding the former proceedings because this defense always raises new matters that are outside the pleadings. Therefore, the plaintiff argues that the defendant did not meet his burden of production with regard to this defense. Plaintiff asserts that he was prejudiced by the plaintiff's omissions because without specific allegations, citations to the previous record, and affidavits, he could not properly defend the motion to dismiss.

This argument has no merit. Platsis was both party to and counsel in the previous suit and as such he was intimately familiar with the factual and legal bases of defendant's motion. Therefore, he cannot claim that he was prejudiced by the form of the pleadings. *See Wright v. Holbrook*, 794 F.2d 1152 (6th Cir. 1986).

We also affirm the district court's conclusion on the merits of the res judicata issue. The court engaged in a lengthy analysis of the basis for dismissing the suit. First, the court noted that Potvin was initially included in the

earlier suit against defendant Hutton but was later voluntarily dismissed from the suit by the plaintiff. Additionally, the court reviewed the new complaint against Potvin and found that each of the allegations that Potvin had violated Rule 10b-5 had been made in the suit against Hutton and those claims were resolved by a finding that 10b-5 had not been violated. The court determined that in certain circumstances mutuality is no longer required for claim preclusion and held that this was such a circumstance because (1) the stranger to the first action is so closely related to one of the parties that a subsequent claim will merely repeat the prior claim; (2) there was no reason why the plaintiff could not have asserted these claims in the prior proceeding; and (3) the precluded plaintiff had a full and fair opportunity to litigate the issues involved during the prior proceeding.

Plaintiff now asserts on appeal that his complaint against Potvin was "intended to assert" a suitability claim and a churning claim. He acknowledges that he did not allege these actions in his complaint, but asserts that the district court denied him an opportunity to amend his complaint before the court granted the motion to dismiss. However, plaintiff is not appealing the court's denial of plaintiff's motion to amend. In fact, the district court's docket sheet does not indicate that plaintiff ever moved to amend his complaint after the defendants moved for dismissal, although two months passed between the defendant's motion for dismissal and the order granting that motion. Consequently, we affirm the dismissal of plaintiff's claim against Potvin on res judicata grounds.

III. CONCLUSION

For the reasons stated above, We Reverse the judgment of the district court finding a violation of Rule 10b-5, common law fraud, and innocent misrepresentation, and We Affirm the district court's dismissal of all other claims.

No. G86-1030 CA5
UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

GEORGE J. PLATSIS,
individually and on behalf of
his professional corporation and
GEORGE JAMES PLATSIS, P.C.,
a Michigan corporation,

Plaintiffs,

v

E.F. HUTTON & COMPANY, INC.,
and JOSEPH POTVIN,

Defendants.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This is an action brought pursuant to section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, 17 C.F.R. section 240.10b-5. Also included in the action are two pendent state law claims for fraud and innocent misrepresentation. In December, 1980, the remaining Plaintiff, George James Platsis, P.C., purchased $351,000 in utility

bonds from the defendants, E.F. Hutton and Company, Inc. and its broker, Joseph Potvin. The plaintiff alleges that the defendants misrepresented and omitted to state a variety of material facts in connection with the sale of these bonds.

The case was tried before the Court sitting without a jury over a period of six days. The case is now ready for decision.

FINDINGS OF FACT

Based upon the testimony and exhibits received at trial, the Court makes the following findings of fact as required by Fed. R. Civ. P. 52(a):[1]

1. Plaintiff George James Platsis, P.C. (the "Corporation") is a professional corporation duly organized and existing under the laws of the State of Michigan. The Corporation maintains its principal place of business in Okemos, Michigan.

2. George James Platsis is an attorney licensed to practice law in the State of Michigan. He is, and was at all times

material to this action, a solo practitioner and trial attorney, as well as the sole shareholder and sole employee of the plaintiff Corporation. Mr. Platsis attended law school at the University of Michigan. He also attended medical school for three years, where he was in the upper one-third of his class. Prior to attending private law practice, Mr. Platsis worked for the Federal Trade Commission for approximately two years. He later also worked for approximately one year in the Consumer Protection Division of the Michigan Attorney General's Office, where part of his responsibilities included rooting out consumer fraud. Mr. Platsis was originally a party plaintiff to this action; however, he was dismissed in his individual capacity from the proceeding pursuant to the Order of Judge Robert Holmes Bell dated August 19, 1987. Mr. Platsis served as the Corporation's attorney at trial, having been substituted (at his own request on behalf of the Corporation) for attorney Mark Light

approximately one month before the trial began.

3. Defendant E.F. Hutton and Company, Inc. ("Hutton") was, at all time material to this action, a corporation and major national brokerage firm licensed by the Securities Exchange Commission. Hutton was acquired by Shearson Lehman, Inc. in 1986 and is now known as Shearson Lehman Hutton, Inc.

4. Defendant Joseph Potvin is a resident of Lansing, Michigan. Mr. Potvin graduated from Michigan State University with a degree in marketing and finance, and have been employed in the securities industry since 1975. He began his securities career as an account executive with Merrill Lynch in Southfield, Michigan. In 1976, he was instrumental in the opening of Hutton's Lansing office, where he was employed as an account executive at all times relevant to this action. He also served, during the time period in question, as tax shelter coordinator for Hutton's Lansing office. Mr.

Potvin has had extensive training in the area of tax shelters. Part of his responsibilities as tax shelter coordinator included training other Hutton employees in the use of tax shelters. Mr. Potvin was and is licensed by the National Association of Securities Dealers, the New York Stock Exchange, the American Stock Exchange, and under the Michigan Blue Sky Authority. He has been employed since 1987 as a vice president of investments with Prudential Bache Securities, Inc.

5. Before October 1980, neither Mr. Platsis nor his Corporation had ever purchased or otherwise invested in bonds. Mr. Platsis' investment experience was limited to ownership of 52 shares of Ford Motor Company (which he acquired as payment for a debt) and ownership of a "couple hundred" shares of a mutual fund.

6. Mr. Platsis first contacted Hutton's Lansing office in October, 1980. He anticipated receipt (in October or November

1980) by the Corporation of a $500,000 contingency fee earned as a result of a large personal injury judgment he had obtained on behalf of a client, a Mr. Richard Pierce. Mr. Platsis believed the fee to be a "recovery of a lifetime" for a solo practitioner, and he desired a means of preserving as much of the fee as possible for his family, as well as for the Corporation, to provide capital which would permit the financing of medical malpractice and other client contingency fee cases typically handled by Mr. Platsis. He was particularly concerned about the personal tax consequences which would result from the receipt of such a large, lump sum fee as wages from the Corporation late in the tax year. He also wished to maximize the after-tax return on the funds.

7. In October, 1980, Mr. Platsis contacted James Kirkman, the office manager at Hutton's Lansing office. Mr. Platsis had been referred to Hutton by an attorney

friend, Bill Schwann, who was also a personal friend to Mr. Kirkman. Upon hearing Mr. Platsis' explanation of his situation, particularly the receipt of the Pierce fee, Kirkman referred him to defendant Potvin, naming Potvin as the tax shelter "expert" in the Lansing office.

8. Mr. Platsis and Mr. Potvin met a number of times, and had a number of telephone conversations between October, 1980 and December 19, 1980. The exact number of meetings and/or discussions is unclear. In October 23, 1980, Platsis deposited the Corporation's entire $500,000 contingency fee in Hutton's money market fund, which paid daily interest.[2]

9. At one early meeting or during one early conversation, Mr. Potvin referred Mr. Platsis to Hutton's Personal Financial Management ("PFM") department. The PFM department provided, for a $5,000 fee, financial planning services. These services included a detailed review of the client's

financial situation, as well as specific recommendations regarding tax, investment, and estate planning. Mr. Platsis did not avail himself of the PFM services because he considered the fee prohibitive, and believed he could perform any necessary analysis himself.

10. During another early meeting or conversation, Potvin suggested that Platsis seek the advice of a tax accountant for assistance in tax return preparation. Mr. Platsis accepted this advise and consulted a tax accountant, who prepared his 1980 returns. Prior to 1980, Mr. Platsis had prepared the returns himself.

11. Potvin also, during an early meeting or conversation with Platsis, referred Platsis to a firm which could assist him in establishing a retirement plan with some of the contingency fee funds. Again, Platsis accepted this recommendation and ultimately placed $190,000 of the funds in a pension plan.

12. During their meetings and/or telephone conversations occurring between October, 1980 and December 19, 1980, Potvin and Platsis discussed a variety of investment options. Potvin gave Platsis a copy of a Hutton publication entitled "Understanding Tax Shelters," which contained discussions of a variety of investments including real estate limited partnerships, oil and gas limited partnerships, equipment leasing programs, cattle feeding and breeding programs, and municipal bonds. This booklet did not contain any discussion regarding utility bonds, which were the type of bonds ultimately purchased by the Corporation. However, Mr. Potvin and Mr. Platsis discussed the advantages and disadvantages of all types of fixed income securities, including government bonds, corporate bonds, and utility bonds. Mr. Platsis chose to invest the Corporation's funds in investment grade utility bonds over other types of bonds and over other types of investments; he chose

utility bonds because they paid "the highest interest" and were "just as secure as government bonds." [3]

13. Mr. Platsis also decided to purchase from Hutton $235,000 worth of oil and gas limited partnership programs, for the purpose of sheltering some of the contingency fee income which he received from the Corporation. These oil and gas program purchases were subsequently transferred to Mr. Platsis by the Corporation. (Mr. Platsis also subsequently invested an additional $10,000 of his own personal funds in an oil and gas program recommended to him by Mr. Potvin.) The Corporation's purchase of these oil and gas programs is not at issue in this action. Indeed, after suffering large losses in the programs, Mr. Platsis, in his individual capacity, filed a previous lawsuit against Hutton, alleging, inter alia, that Hutton violated federal and Michigan securities laws in connection with the sale of these limited partnership investments

These allegations were resolved in Hutton's favor. Platsis v E.F. Hutton & Co., Inc., 642 F. Supp. 1277 (W.D. Mich 1986), Aff'd, 829 F.2d 13 (6th Cir. 1987), cert. denied, 485 U.S. 962 (1988). Mr. Platsis filed the present action on behalf of himself and the Corporation after realizing that the oil and gas lawsuit against Hutton would not be settled favorably to him. Mr. Platsis was extremely dissatisfied with the outcome of the oil and gas lawsuit.

14. Mr. Platsis' primary objective in seeking Mr. Potvin's advice was to defer and reduce his personal income tax burden which would have resulted from receipt of the Pierce contingency fee as wages from the Corporation. His secondary objective was to maximize the return on his investment, while avoiding risk to his capital.

15. Prior to the Corporation's purchase of the utility bonds, Mr. Potvin explained to Mr. Platsis that the purpose of the investment was to shelter Mr. Platsis'

personal income from taxes,[4] and to engage in an interest rate "timing play." He explained that the "timing play" would provide returns on the investment because the bonds would appreciate in value if interest rates fell. Mr. Potvin believed, and told Mr. Platsis, that interest rates were at an "all-time high" in December, 1980, and that they were certain to fall within the next year. Mr. Potvin further told Mr. Platsis that any appreciation realized on the bonds would be taxed at capital gains rates (which were lower than Mr. Platsis' personal income tax rate), provided that he held the bonds for longer than six months.[5] Hutton's economic department had recommended this investment strategy for use by its brokers as a means of sheltering clients' income. Use of this strategy had also been recommended at Hutton broker training sessions. Mr. Platsis found the timing play strategy to be consistent with his investment objectives.

16. Before the Corporation purchased

the bonds in question, Mr. Potvin told Mr. Platsis that Yields to maturity on discounted investment-grade utility bonds were "14 percent or higher."

17. On December 19, 1980, Mr. Platsis informed Mr. Potvin of his decision to purchase, on behalf of the Corporation, the discounted investment-grade utility bonds. Mr. Potvin immediately began to assemble a portfolio of such bonds. The following purchases were executed by Mr. Potvin:

Issuer	Price Per Bond	No. of Bonds	Total Purchase	Date	Source
New York State Elec.& Gas	$652.50	100	$65,250.00	12/19/80	Hutton
Ohio Edison	603.75	25	15,093.75	12/22/80	NYBE
Ohio Edison	618.75	25	15,468.75	12/22/80	Hutton
Ohio Power	685.00	15	10,275.00	12/22/80	Hutton
Alabama Power	553.00	100	55,300.00	12/22/80	Hutton
Alabama Power	627.50	25	15,687.50	12/22/80	Hutton
Detroit Edison	585.00	10	5,850.00	12/23/80	NYBE
Cleveland Elec.	702.50	25	17,562.50	12/23/80	NYBE
Alabama Power	605.00	6	3,630.00	12/23/80	NYBE
Alabama Power	560.00	12	6,720.00	12/23/80	NYBE
Pennsylvania Power	566.25	25	14,156.25	12/24/80	Hutton
Georgia Power	640.00	25	16,000.00	12/24/80	Hutton
Boston Edison	603.75	50	30,187.50	12/24/80	Hutton
Arkansas Power and Light	593.75	25	14,843.75	12/29/80	Hutton
Western Mass. Electric	670.00	75	50,250.00	12/29/80	Hutton
Boston Edison	605.00	25	15,125.00	12/30/80	Hutton
Total		568	$351,400.00		

18. Before each of the individual purchases, Mr. Potvin and Mr. Platsis discussed bond yields to maturity; coupon rates; the issuers, maturities, and prices. In addition, they discussed the bond ratings. They did not discuss the liquidity[7] of the bonds. Furthermore, although some of the bonds were purchased by Mr. Potvin from Hutton's own inventory, and some were purchased on the New York Stock Exchange, Mr. Potvin did not inform Mr. Platsis prior to Mr. Platsis' authorization of the purchases that some of the bonds were from Hutton's inventory. Although Mr. Platsis viewed computer printout lists, generated by Mr. Potvin, of bonds available from Hutton's inventory, Mr. Potvin did not discuss these printouts with Mr. Platsis in any great detail, and there is no evidence indicating whether the printout themselves listed the source of the described bonds. Mr. Platsis believed, until after receiving confirmation slips subsequent to the transactions, that

the Corporation had purchased the bonds form third parties, and that it would be charged a reasonable commission for Hutton's execution of the purchases. Before December 19, 1980, the two men did not discuss the amount of Mr. Potvin's commissions. Mr. Potvin did not tell mr. Platsis, either before or after the purchases, the Hutton charged "mark-ups" or bid/ask "spreads"[8] on purchases made from inventory. No offering materials or prospectuses were provided to Mr. Platsis.

19. Some of the individual bond purchases executed by Mr. Potvin on behalf of the Corporation were authorized by Mr. Platsis immediately preceding the purchase, while other purchases were merely ratified by Mr. Platsis thereafter. Mr. Potvin typically would locate suitable bonds for sale, and contact Mr. Platsis to obtain authorization for the purchase. If he was unable to contact Mr. Platsis, he would make the purchase anyway, and contact Mr. Platsis as soon as possible to obtain his approval. Mr.

Platsis, acting upon Mr. Potvin's recommendations, authorized all of the subject utility bond purchases. Had Mr. Platsis disapproved any of the transactions, they would have been rescinded. Mr. Potvin did not exercise discretion over the Corporation's account.

20. Mr. Platsis received a confirmation slip form Hutton after each purchase. These slips were generally received within a few days after the purchase, but before the settlement date. The slips described the purchase, including, inter alia, the issuer, amount of bonds purchased, the purchase price, and for the New York Bond Exchange transaction only, the amount of the commission charged to the Corporation. The front of the slips contained a small section entitled "Code," while the reverse side contained an explanation of any codes appearing in this section. One of these codes indicated whether Hutton was acting in an "agent" capacity, or in a "principal" or

"market maker" capacity. Mr. Platsis reviewed both sides of the slips which he received from Hutton. In addition to the confirmation slips for the individual transactions, Mr. Platsis received monthly statements from Hutton summarizing the status of the Corporation's account. He reviewed these statements as well.

21. Upon receiving and reviewing the confirmation slips, Mr. Platsis did not complain about the reported transaction. He did ask Mr. Potvin about a discrepancy which he noted between the slips and a monthly account statement, and he received a satisfactory explanation.

22. The confirmation slips disclosed that commissions ranging from $45 to $187.50 were charged on the New York bond Exchange transactions; the total commission charged by Hutton on the New York Bond Exchange transactions equalled $585. The total of the New York Bond Exchange purchases, exclusive of commissions, was $48,856.25. No evidence

was presented at trial that the commissions charged on the bond exchange purchases were excessive, or that these transactions were otherwise fraudulent.

23. The confirmation slips disclosed that Hutton had itself sold some of the bonds to the Corporation as a "principal" or "market maker." The slips reported no commissions on these particular purchases, which were made from Hutton's inventory. Mr. Platsis asked Mr. Potvin why no such amounts appeared on the confirmation slips. Mr. Potvin explained to Mr. Platsis that the bonds had been purchased from Hutton's inventory and that no commissions were charged on inventory transactions. Mr. Potvin did not at that time, or at any other time before or after the purchases, tell Mr. Platsis that Hutton received compensation for inventory transactions, in the form of spreads or mark-ups. Mr. Potvin also did not tell Mr. Platsis, at any time, either before or after the purchases, that he (Mr. Potvin)

received compensation in the form of "production credits"[9] for making sales from Hutton's inventory. Mr. Potvin intentionally left Mr. Platsis with a definite impression that neither he (Mr. Potvin) nor Hutton profited from the inventory transactions.[10] This conversation took place in late December, 1980 or early January, 1981; the exact date is unclear. In any event, this conversation before Mr. Platsis received all of the confirmation slips for the bond purchases.

24. The Corporation's purchases from inventory totalled $302,543.75. Mr. Potvin's sale of the inventory bonds to the Corporation generated undisclosed gross "production credits" in the amount of $8,718.75. These production credits were hidden within the price of the bonds and were included within the spreads charged. Mr. Potvin personally received approximately 40 percent of this amount (or approximately $3,487.50) in compensation for the inventory

transactions.

In 1980, Mr. Potvin serviced approximately 250 clients at Hutton. His income for that year was approximately $100,000. Thus, Mr. Potvin's compensation for the Corporation's account was relatively substantial; had he eared similar amounts from all of his clients, his income would have exceeded $870,000.

25. At trial, the Corporation was unable to produce direct evidence of the actual compensation received by Hutton itself--is "spread" or "mark-up"--for the inventory bonds purchased. The Corporation's inability to produce this direct evidence of Hutton's compensation is attributable to Hutton's failure to produce documents subpoenaed by the Corporation.[11]

26. The bid/ask spread for the Corporation's inventory purchases could have been reconstructed using trade tickets and confirmation slips for the period in question.[12] A federal regulation in effect at

the time of the transactions in question required Hutton to maintain such transaction records for six years. 17C.F.R. section 240.17a-r. The plaintiff's action was filed in November, 1986--within this six year period.

27. Hutton's failure to produce the requested documents has substantially prejudiced the Corporation's effort to prove its claim of excessive mark-ups or spreads, as well as the amount of damages for nondisclosure of mark-ups or spreads.[13] Although at trial Mr. Potvin claimed lack of knowledge of Hutton's costs or mark-ups for the particular inventory bonds in question, he testified under oath at a deposition taken before trial that $25 to $50 per bond spread between bid and ask prices were within the "normal" range charged by Hutton. He did not refute this previous testimony at trial.

28. Even assuming that spreads of $25 to $50 per bond were charged for the Corporation's bonds, the Court cannont find

that such spreads were "excessive" as a matter of fact or law. The evidence presented at trial was that large institutional investors are typically charged smaller spreads in bond transactions than are smaller, retail investors. One reason for this difference is that institutional investors tend to be highly sophisticated and require less assistance from brokers. Spreads greater than a fraction of a percent are considered "excessive"--for institutional investors. Plaintiff's expert, Mr. Stasen, concluded that the spreads charged in this case were excessive. However, the Court finds this testimony to be based on standards for institutional investors. Mr. Stasen testified that the plaintiff was not an institutional investor, but that in his opinion, he "should have been treated" as one. The Court cannot agree that the plaintiff should have been treated as an institutional investor. The plaintiff claims a lack of sophistication, yet should be

treated as a sophisticated institutional investor. The Court finds that the plaintiff was not a sophisticated bond investor, nor an institutional investor.

30. In order for the Corporation to make a profit on its timing play, interest rates would have to have fallen by one and one-half to two percent within one year. According to Mr. Farmer, a bond buyer such as the Corporation would pay spreads charged by the brokerage house not only in purchasing the bonds, but again in reselling the bonds to take advantage of falling interest rates and resulting rising prices. Mr. Farmer also testified that even if interest rates fell by two percent, however, large spreads of up to $50 per bond could destroy any potential profits of the timing play. The amount of spreads was thus material.

31. Mr. Potvin's failure to disclose his receipt of production credits for the Corporation's inventory purchases amounts to an intentional nondisclosure of a material

fact.

32. Mr. Potvin's failure to disclose the amount of spreads or mark-ups on the inventory bonds purchased by the Corporation amounts to an intentional nondisclosure of a material fact.

33. The Corporation has suffered actual damages in the amount of $38,000, which represents the amount of undisclosed mark-ups charged by Hutton.[14]

34. The Court finds that additional claims of damages by the plaintiff are not supported.[15]

35. The Court finds that the Corporation is not entitled to rescissionary damages, or the return of its original investment. The Corporation no longer owns any of the bonds which it purchased from Hutton, having transferred them to its employee, Mr. Platsis. The bonds are presently maintained in Mr. Platsis' pension plan, to which they were transferred to him at a profit of $93,174.[16] No evidence was

presented as to the precise date transfer by the Corporation to Mr. Platsis, nor the amount of income earned on the bonds by the Corporation before the time of transfer. It would be inappropriate of the Court to require the defendants to return the entire among of the Corporation's original investment without subtracting the amount of income produced by the bonds during the Corporation's holding period.[17]

36. The Court finds that the Corporation is not entitled to exemplary damages.

37. The Court finds that the Corporation is not entitled to an award of attorney fees. No evidence was presented at trial as to the amount of attorneys' fees incurred by the Corporation.

38. The Corporation is entitled to an award of prejudgment interest as provided under Michigan statutory law. The Corporation is not entitled to an award of pre-filing interest.

39. The Corporaton is entitled to recover its costs incurred in bringing this suit.

CONCLUSIONS OF LAW

In accordance with Fed. R. Civ. P. 52(a), the Court reaches the following conclusions of law:[18]

A. The Court has jurisdiction over the Corporation's federal law claim pursuant to 28 U.S.C. section 1441(b). The Court has pendent jurisdiction over the Corporation's state law claims.

B. Venue is proper in this district.

c. The utility bonds purchased by the Corporation from Hutton are securities within the meaning of 15 U.S.C. section 78j(b).

D. Defendants Hutton and Mr. Potvin used an instrumentality of interstate commerce in connection with the sale of utility bonds to the Corporation.

E. In order to prove liability for violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the

Securities and Exchange Commission, the plaintiff must show that in connection with the sale of the bonds, the defendants misrepresented or omitted to state a material fact, either knowingly with the intent to deceive the plaintiff or with reckless disregard for the plaintiff's investment objectives. See Ernst& Ernst v Hochfelder, 425 U.S. 185 (1976); Mansbach v Prescott, Ball & Turben, 598 F.2d 1017, 1023-25 (6th Cir. 1979). Further, the plaintiff must show that the misrepresented or omitted fact was material in the sense that it is substantially likely that a reasonable investor would consider the matter important in making an investment decision. SEC v Washington County Utility Dist., 676 F.2d 218, 225 (6th Cir. 1982).

F. The factors to be considered in determining the scope of a defendant's duty to disclose information in connection with the sale of securities are 1) the relationship of the defendant to the

plaintiff; 2) the defendant's access to information, compared to that of the plaintiff; 3) the benefit to the defendant derived from the relationship with the plaintiff; 4) the awareness by the defendant of the plaintiff's reliance on him or her, and 5) the defendant's activity in initiating the securities transactions in question. Kirkland v E.F. Hutton and Co., Inc., 564 F. Supp. 427, 441 (E.D. Mich. 1983). Consideration of these factors in the context of this case leads the Court to conclude that Mr. Potvin had a duty to disclose to the plaintiff the full extent of any conflict of interest present in the transactions, including the amount of production credits and spreads. Although the relationship between the plaintiff and Mr. Potvin was purely a commercial one, it does appear to have been a traditional broker/client relationship in which Mr. Platsis generally relied on Mr. Potvin's recommendations in making a determination to

purchase the particular bonds which he eventually purchased for the Corporation. An unsophisticated bond investor must trust his broker to determine whether a transaction is fair. This point brings us to a second factor--the defendant's access to information compared to that of the plaintiff. While Mr. Platsis undoubtedly had access to public information containing general descriptions of bonds, the defendants alone had access to information regarding the compensation which they received for plaintiff's purchases. Furthermore, the benefit which Mr. Potvin received from the Corporation's account was fairly substantial, considering that the Corporation was only one of Mr. Potvin's 250 clients and that he earned approximately $3,400 from the account within a one-month period. The next factor-- the awareness by the defendant of the plaintiff's reliance--militates against a duty of disclosure in this case. The Court has observed that Mr. Platsis is an intelligent man. Mr. Platsis

asked intelligent questions, acting as though he were an "informed" investor. The Court finds that Mr. Platsis conveyed the impression that he was a much more sophisticated bond investor than he indeed was. Finally, with respect to the final factor--Mr. Potvin's activity in initiating the transactions--clearly it was Mr. Platsis who initiated contact with Hutton, but the evidence also shows that Mr. Potvin actively encouraged Mr. Platsis to invest the Corporation's funds in utility bonds. "The duty to disclose information is measured by a flexible standard." Id. Although the Court cannot go so far as to conclude that Mr. Potvin had a duty to disclose to Mr. Platsis information which was readily available to the public in general, consideration of the above five factors leads the Court to conclude that Mr. Potvin had a duty to disclose the full extent of any conflict of interest.

G. Hutton was the market maker[19] in the

majority of the securities purchased by the plaintiff. Failure to disclose market maker status constitutes an omission of material fact in violation of Rule 10b-5. Chasins v Smith, Barney & Co., Inc., 438 F.2d 1167, 1172 (2d Cir. 1970). However, hutton disclosed its market maker status to Mr. Platsis in the confirmation slips, which Mr. Platsis received and reviewed before the confirmation settlement dates. Thus, the plaintiff was aware, before the completion of the purchases, that it was purchasing from Hutton itself.

H. The existence and amount of Hutton's spreads or mark-ups and of Mr. Potvin's production credits were not disclosed to the plaintiff. These facts should have been disclosed. Mr. Platsis expected Mr. Potvin to receive reasonable "commissions" for the bond sales. Although the "commissions" charged on the New York Bond Exchange purchases were disclosed, the "production credits" which Mr. Potvin received for the

inventory transactions were not disclosed. The Court finds that the production credits provided an additional incentive for Mr. Potvin's recommendations which a reasonable investor would most likely consider important in determining whether to purchase.[20] Furthermore, Mr. Platsis' reasonable belief that the Corporation was acquiring the inventory bonds at "cost"--which was promoted by Mr. Potvin--was even more of an inducement to enter into the transactions. Campbell v Shearson/American Express, Inc., No. 82-70594, slip op. at 60 (E.D. Mich. August 9, 1985).

Likewise, the spreads or mark-ups were also material information. A reasonable investor, had he known the extent of the mark-ups, could have determined that his returns would be diminished. Institutional investors, who tend to be sophisticated and familiar with the bond market, and who know how to calculate yield to maturity, may reject bond purchases which include spreads

greater than a fraction of a percentage.

While yield to maturity is the most important factor in evaluation bond purchases, yield is not the only material factor.[21] In this case, nondisclosure of the amount of the spreads or mark-ups is material because large spreads could have destroyed the anticipated return on the Corporation's investment. Whether mark-ups constitute material information is a question for the fact finder. Krome v Merrill Lynch and Co., Inc., 637 F. Supp. 910, 916 (S.D.N.Y. 1986).[22]

I. The Court is convinced by clear and convincing evidence that Mr. Potvin acted with the requisite intent in failing to disclose the amount of spreads and production credits. Although Mr. Potvin did not know the amount of spreads which Hutton charged for the particular bonds purchased by the Corporation, he did know the range of spreads typically charged by Hutton. He also certainly knew the amount of his own production credits. His behavior in not

disclosing this information was knowing an deliberate. His evasive response to Mr. Platsis' inquiry regarding why no "commissions" appeared on the inventory purchase confirmation slips further suggests that he was not concerned with whether the plaintiff was misled by the nondisclosure of Hutton's and his own compensation. He was content to allow Mr. Platsis to believe that the Corporation was "getting a deal" on the inventory bonds because he was a large investor.

The Court finds further evidence of intent in the fact that the investment strategy as described by Mr. Potvin was not one which was (or is) widely-used or recognized as a legitimate strategy by experts in the securities industry. The intent of the investment strategy, as explained to Mr. Platsis by Mr. Potvin, was to make an interest rate "timing play"; however, utility bonds are generally not used to make timing plays. Mr. Potvin had not

previously used utility bonds to time the market. Interestingly, had Mr. Potvin sold the plaintiff Treasury securities, which are generally used in timing plays, he would have earned only a nominal commission, as opposed to the substantial production credits which he earned for the inventory utility bonds.[23]

J. Mr. Platsis was not a sophisticated bond investor in December, 1980, and material facts were not disclosed to him. Reliance may be presumed where the plaintiff can justifiably expect that the defendants would have disclosed the material information. Ross v Bank South, N.A., 885 F.2d 723, 728 (11th Cir. 1989).

K. The Court concludes that the plaintiff has established a violation of section 10(b) of the Securities Exchange ACt of 1934, 15 U.S.C. section 78j(b), and Rule 10b-5, 17 C.F.R. section 240.10b-5.[24]

1. In order to recover for actual fraud under Michigan law, the plaintiff must prove the following elements: 1) that the

defendant made a material representation; 2) that the representation was false; 3) that the defendant knew the representation was false when he made it, or that he made it recklessly, without knowledge of its truth and as a positive assertion; 4) that the representation was made with the intent to induce the plaintiff's reliance; and 5) that the plaintiff acted in reliance upon the representation; and 6) the plaintiff thereby suffered injury. In re Estate of Swantek, 172 Mich. App. 509, 432 N.W.2d 307, 310 (1988), appeal denied, 432 Mich 874 (1989). The false material representation required to establish fraud may be satisfied by the failure to disclose facts which the defendant has a duty to disclose. Fassihi v Sommers, Schwartz, Silver, Schwartz & Tyler, 107 Mich. App. 509, 309 N.W.2d 645, 649 (1981). A claim of innocent misrepresentation requires proof of the same elements, as does a claim of fraud, with the exception that the misrepresentation need not be made knowingly

or recklessly. State-William Partnership v Gale, 169 Mich. App. 170, 425 N.W.2d 756, 761 (1988). In addition, to support a claim of innocent misrepresentation, the plaintiff must prove that its injury actually benefitted the defendant. Id.

For the reasons set forth in the Findings of Fact and Conclusions of Law above, the Court concludes that the plaintiff has also established by clear and convincing evidence that it is entitled to recovery for fraud and innocent misrepresentation under Michigan common law.

In this case, Mr. Platsis was undoubtedly concerned about the amount of compensation Mr. Potvin would receive for the bond purchases, as is evidenced by his inquiry regarding commissions. The failure of Mr. Potvin to disclose the amount of compensation which he and Hutton would receive was a factor in the Corporation's decision to go through with the utility bond transactions, for had Mr. Platsis realized

that the defendants received greater compensation for inventory sales than for agency sales he very likely may have chosen to purchase other bonds or take the Corporation's business elsewhere, perhaps to a discount brokerage.

With regard to innocent misrepresent-action, Michigan courts have eliminated the requirement of proof that the misrepresentation be acted upon. U.S. Fidelity and Guaranty Co. v Black, 412 Mich. 99, 313 N.W.2d 77,85 (1981). Thus, it is unnecessary to prove separately that the defendant intended the plaintiff to rely on the misrepresentation; all that is required is that the representation be made in a transaction between the parties where the defendant should realize that the misrepresentation would be relied on. Id. This component is satisfied in this case.

Furthermore, with regard to the element of an innocent misrepresentation claim which requires that the plaintiff's injury inure to

the benefit of the defendants, the defendants in this case benefitted from the plaintiff's injury. Mr. Potvin benefitted by receiving production credits. Hutton benefitted as well; whether or not it received "profits" per se on the Corporation's purchases, Hutton gained by reducing its inventory.

M. Although Hutton is named as a defendant, the plaintiff's sole contact with Hutton (which is relevant for the purposes of this action), was with Mr. Potvin. However, Hutton may incur liability for Mr. Potvin's activities under traditional agency principles. Holloway v Howerdd, 536 F.2d 690, 695 (6th Cir. 1976). under principles of respondeat superior, an employer is liable for the actions of its employee if they are undertaken in the course and within the scope of the employee's employment. Burch v A & G Associates, Inc., 122 Mich. App. 798, 333 N.W.2d 140, 142 (1983). In this case, Mr. Potvin was, at all relevant times, acting in the course of his employment as an account

executive and tax shelter coordinator for Hutton. In addition, he was clearly acting within the scope of his employment in selling bonds from Hutton's inventory; Hutton compensated him for this activity by awarding him production credits--a share of its spread. Finally, the evidence establishes that it was within Mr. Potvin's authority to withhold information regarding spreads and production credits; Hutton's own confirmation slips did not disclose this information to clients.

N. In determining the amount of actual damages, the Court has been faced with the difficulties presented by Hutton's failure to produce documents which would indicate the amount of its mark-ups or spreads for the bonds purchased by the Corporation. Where a party fails to introduce documents in his possession, this failure may invoke an adverse inference. National Labor Relations Board v Evans Packing Co., 463 F.2d 193, 197 (6th Cir. 1972) (citing McCormick, Evidence

section 249 (1954) and II Wigmore, Evidence section 285, 291 (3d ed. 1940). Even where a party claims that such records are not available, an adverse inference may be drawn where the documents ought to have been preserved and kept available. Berry v School Dist. of Benton Harbor, 442 F. Supp. 1280, 1299 (W.D. Mich. 1977). In this case, Hutton was required by law to retain trading documentation for six years. It had notice of the plaintiff's lawsuit before the end of this six year period, and should have retained any documents pertinent to the plaintiff's account. In adopting the plaintiff's expert's testimony as to damages, the Court invokes an inference that Hutton profited from the sale of the inventory bonds.

O. The Court, in finding the amount of plaintiff's damages to be $38,000, adopts Mr. Stasen's testimony as to the amount of Hutton's spreads for the bonds purchased by the Corporation.[25] The Court finds that Mr.

Stasen's testimony in this regard to be credible and reasonably accurate. Indeed, in the absence of Hutton's own documents which would show its earnings on the transactions in question, Mr. Stasen's testimony is the best evidence available to the Court on the question of damages. See Knightsbridge Marketing Services, Inc. v Promociaones y Proyectos, S.A., 728 F.2d 572 (1st Cir. 1984) (district court did not err in relying upon experts' testimony as to the amount of lost commissions in breach of contract action, where defendant failed to produce its earnings figures).

P. The Court cannot adopt plaintiff's theory of "yield loss" damages of $89,000, nor its theory as to $112,000 damages the Corporation allegedly suffered due to its investment in discount utility bonds rather than municipal bonds.[26]

The plaintiff's request for "yield loss" damages is essentially a request for damages representing lost profits over the past nine

years due to alleged overpayment for the securities. The Corporation has not owned the bonds for the past nine years--the bonds are now in Mr. Platsis' pension plan. The Court cannot award the plaintiff sums representing lost profits for a period during which the bonds were not owned by it.

The Court believes the plaintiff's $112,000 damage theory to be more appropriate to an unsuitability claim. The plaintiff has not properly pleaded a claim of unsuitability as a violation of section 10(b) and Rule 10b-5.[27] Fed. R. Civ. P. 9(b) requires that "in all averments of fraud...the circumstances constituting fraud...shall be stated with particularity." To properly plead a claim of unsuitability, the plaintiff must specifically identify the transactions at issue and indicate why they were unsuitable. Polera v Altorfer, Podesta, Woolard & Co., 503 F. Supp. 116, 119 (N.D. Ill. 1980). The third amended complaint contains no allegations which can be even remotely

construed as alleging that the utility bonds recommended by Mr. Potvin were an unsuitable investment for the Corporation.

Q. Exemplary damages may be awarded if allowable under state law when a state law violation is joined with a 10b-5 complaint. Kirkland, 564 F. Supp. 446. Exemplary damages are available under Michigan law if they compensate the plaintiff for the "'humiliation, sense of outrage, and indignity' resulting from injuries 'maliciously, wilfully and wantonly' inflicted by the defendant." Kewin v Massachusetts Mutual Life Ins. Co., 409 Mich. 401, 295 N.W.2d 50, 55 (1980) (quoting McFadden v Tate, 350 Mich 84, 89, 85 N.W.2d 181 (1957). In addition, Michigan law permits an award of exemplary damages to compensate for injuries not capable of precise computation resulting from malicious conduct. Joba Construction Co., Inc. v Burs & Row, Inc., 121 Mich. App. 615, 239 N.W.2d 760, 773 (1982). A corporation may be

entitled to exemplary damages. Id.

The plaintiff argues that the defendants' behavior in this case was "outrageous," but the Court cannot agree. The transactions were purely commercial. Furthermore, because the plaintiff's damages in terms of undisclosed spreads and production credits are capable of measurement (and have indeed been measured by plaintiff's expert), and the plaintiff has not proven any additional injuries (such as damage to its reputation) which are not capable of measurement, exemplary damages are not appropriate in this case.

R. The plaintiff is entitled to an award of prejudgment interest at the rate of 12 percent, to be calculated from November 6, 1986, to the date of the complaint entered in this case. M.C.L.A. section 600.6013(4). The plaintiff is further entitled to an award of post-judgment interest as provided in 28 U.S.C.A. section 1961.

S. The amount of mark-ups was uncertain

until the time of trial, when the plaintiff's expert provided a value for them. In addition, this action was not commenced until virtually the eve of the limitations period, and has continued for some time, through three amended complaints. Under these circumstances, the Court finds that an award of pre-filing interest would be inappropriate.[28]

T. The Corporation is entitled to recover its costs as provided by law.

U. Still pending before the Court is the defendant's motion under Fed. R. Civ. P. 37(d) for sanctions for the plaintiff's failure to comply with discovery requests served by the defendants on January 17, 1989. The defendants initially filed a motion to compel and for sanctions on March 17, 1989. The next day, the defendants were served with responses to their discovery request. They then withdrew their motion to compel on March 24, 1989, based upon the plaintiff's representation that it would make the

requested documents available for the defendants' inspection. On May 3, 1989, not having been granted inspection by the plaintiff, the defendants renewed their motion to compel. The plaintiff produced the requested documents on May 31, 1989, and on June 15, 1989 the Court dismissed the renewed motion to compel as moot, without addressing the motion for sanctions.

The Court finds that the imposition of discovery sanctions against the plaintiff is not warranted in this case. At the pretrial and hearing on motions held in this matter on November 13, 1989, defense counsel represented that all discovery sought had been produced. The defendants have not indicated that their case has been prejudiced by the delay in production.[29] Given the lack of prejudice occasioned by the delay, the Court denies the defendants' request for sanctions.

CONCLUSION

IT IS THEREFORE ORDERED that judgment be

entered for the plaintiff, George James Platsis, P.C., and against the defendants, E.F. Hutton and Co., Inc. and Joseph Potvin, in the amount of $38,000 plus costs as well as pre- and post-judgment interest as set forth above.

IT IS SO ORDERED.

Dated: April 18, 1990

Wendell A. Miles
Senior Judge

ENDNOTES

1. Any findings of fact which contain conclusions of law should be considered as such.

2. Mr. Platsis had initially planned to deposit this sum with his bank. He declined to do so upon learning that the bank would not pay daily interest. Mr. Platsis also contacted another Lansing stock broker before he contacted Hutton. He declined to invest the Corporation's money with this previous firm because the firm did not pay daily interest.

3. The Corporation also purchased a small number of United States Treasury bills on December 2, 1980. Mr. Platsis and his wife

also purchased some Treasury bills for their personal account. These purchases are not a subject of this lawsuit.

4. Mr. Potvin believed that without investment planning, Mr. Platsis would be in a 50 percent tax bracket upon receipt of the contingency fee from the Corporation.

5. Mr. Potvin also told Mr. Platsis that in addition to appreciating in value, the bonds would produce interest income. He advised Mr. Platsis that placing the bonds on margin would have the effect of sheltering the interest income, because the margin interest expense would be tax deductible. At trial, Mr. Platsis testified that the margin interest costs consumed almost all of the bond interest income. However, there was no evidence presented at trial that the Corporation (as opposed to Mr. Platsis in his individual capacity) purchased the bonds on margin or incurred margin costs.

6. "NYBE" denotes a purchase made pursuant to an order placed by Mr. Potvin on the New York Bond Exchange. "Hutton" denotes a purchase made by Mr. Potvin from Hutton's inventory.

7. Liquidity is defined as the ability to trade bonds daily.

8. A "bid" price is the price which a market maker (such as Hutton) is wiling to pay for a security presented to him for sale. An "ask" price is the price at which a market maker is willing to sell a security when it receives an order for purchase. The difference between these tow amounts is known as the "spread," and represents the market maker's compensation for the transaction.

9. "Production credits" are a means by which

brokerage firms compensate brokers for sales from inventory. A production credit is a revenue allowance attributed partially to the broker and partially to the branch office where the transaction originated. Production credits were not, in 1980, disclosed by Hutton to its customers; they were included within the price charged for the bonds and did not appear on confirmation slips as an addition to the price. Very few brokers practiced disclosure of production credits, mark-ups, or spreads in 1980.

10. In his trial testimony, Mr. Potvin very carefully distinguished "commissions" from "production credits." Unfortunately, he was not so careful in making this distinction to Mr. Platsis either before the bond purchases or upon Mr. Platsis/ inquiry after receipt of the confirmation slips. Notably, Hutton's own internal documents (Defendants' Exhibit C). which were not provided to Mr. Platsis, reported "production credits" to Mr. Potvin under a column entitled "commissions."

The import of Mr. Platsis' "commission" inquiry was clear--he was asking why the slips did not reflect the amount of compensation which Mr. Potvin and Hutton received on these transactions. Mr. Potvin's explanation that no "commissions" had been charged, and his omission to explain what he and Hutton did receive, were calculated to mislead Mr. Platsis into believing that he was receiving "special treatment" from Hutton because he had purchased a sizable amount of bonds. This conversation took place before the settlement dates for at least some of the transaction. It is highly relevant that Mr. Platsis could have, according to Mr. Potvin, rescinded the bond purchases prior to the settlement dates reflected on the transaction slips. Subsequent to this conversation, Mr. Platsis, who had never purchased bonds before,

believed that Hutton had sold the inventory bonds to him at cost because he was a large investor with Hutton. Mr. Potvin's nondisclosure of the spreads and production credits provided active encouragement of this belief. Particularly in light of the testimony of both expert witnesses that large institutional investors are treated more favorably by brokerage houses with respect to the amount of spread typically charged, Mr. Platsis' belief was not unreasonable.

11. On October 3, 1989, the Court ordered Hutton to produce, no later than October 23, 1989, documents demonstrating inter alia, the mark-ups and bid and ask prices for the inventory bonds purchased by the Corporation. Hutton had not produced these documents by the start of trial on November 21, 1989. Mr. Potvin did not know the precise amount of mark-up or bid/ask spreads on the Corporation's bonds. Hutton presented no witnesses at trial who were employed at its bond trading desk in December, 1980; indeed, Hutton presented to witnesses at trial other than Mr. Potvin (who is no longer employed by Hutton) and its expert, Mr. Timothy Farmer.

Hutton argued that it could not produce the documents requested because it could not locate them. In support of this argument, Hutton presented the affidavits of a records coordinator employed by Shearson Lehman Hutton and of a legal assistant employed by its attorney. These affidavits stated that boxes containing confirmation slips and trade tickets for December 1980 and January 1981 had been located, that these boxes did not contain documents relating to the Corporation's account. The Corporation's counsel requested at trial that Hutton be ordered to produce, at trial, its long-term discount utility bond trade tickets for the month of December, 1980. The Court so ordered. However, Hutton produced a box

containing only commodities trade tickets--and no confirmation slips--for that month. The box bore a label which indicated a destruction date of 1987; quite obviously, however, the box was still in existence.

12. Mr. Stasen testified that bid/ask spreads may be reconstructed using trade tickets and confirmation slips for the period in question. Hutton attempted to rebut this testimony through its own expert, Mr. Farmer, who testified that no documents would enable one to re-create bid/ask spreads on inventory purchases. The Court finds this latter testimony of Mr. Farmer to be lacking in credibility. It is difficult to believe that a major brokerage house, which is required by federal law to file tax returns, could not determine the amount of compensation received for a given transaction or series of transactions. Indeed, both Mr. Farmer and Mr. Potvin confirmed that Hutton's bond traders would have known its costs; Mr. Farmer stated that bond traders keep trading blotters which would enable them to know the dealer's costs for a position, while Mr. Potvin stated that Hutton's bond traders were broken down into particular issue groups, and could identify their costs for a bond, as could the head of the corporate bond department.

13. Plaintiff has urged the Court to adopt as evidence of the fair market yields to maturity of its bonds two portfolio evaluations (Plaintiff's Exhibits 20 and 21) prepared by Hutton several months after the transactions in question in this case. These portfolio evaluations purport to describe the Corporation's bonds in terms of price, value, interest rate, income, current yield, and yield to maturity.

The Court finds Plaintiff's Exhibit 21, which purports to value the bonds as of January 31, 1981, to be irrelevant to the

issues presented by this case. The purchases at issue were made in December, 1980. Bond prices may fluctuate daily. Therefore, the January 31 portfolio evaluation is not necessarily determinative of the value of the bonds one month or more earlier.

The Court finds Plaintiff's Exhibit 20, which purports to value the Corporation's bonds as of December 19, 1980 to be unreliable. Although neither of the defendants presented testimony at trial which impeached the accuracy of this portfolio evaluation, at the close of trial they moved for the admission of Deposition Exhibit 3 to Mr. Stasen's deposition (Stasen Depo. Ex. 3). In this exhibit, Mr. Stasen recalculated the bond yields to maturity reflected on the statement, which he found to be overstated in comparison to the bond prices also reflected on the statement. A portion of Mr. Potvin's deposition, which plaintiff has asked the Court to consider with Stasen Depo. Ex. 3, also indicates that the method used to generate the portfolio evaluation was unreliable and produced results which were often inaccurate. In addition, the statement purports to value all of the bonds as of December 19, even though all but one of the Corporation's purchases were made after that date. Finally, decimal point figures have been cut off the right hand side of the document submitted into evidence; assuming that these decimal figures (which would have been part of the yield to maturity column--an important component of bond valuation) were cut off the original document, such a condition would suggest that the document was never represented to be an accurate valuation of the portfolio.

14. This sum is based upon Mr. Stasen's testimony as to damages, which the Court finds credible. Mr. Stasen testified that he

had determined, using a variety of sources typically relied upon by bond traders, that the Corporation could have purchased comparable bonds yielding two percent higher than those it actually purchased. In other words, Hutton could have, and the Court finds that it did, purchase the bonds at yields to maturity averaging 16 percent, and resold those same bonds out of its inventory to the Corporation at yields averaging only 14 percent. Mr. Stasen testified that in reaching his conclusion that yields were 16 percent, he relied upon an examination of bond markets in December, 1980, including a study of Moody's daily reports, studies of new issue bonds and treasury bonds, and a study of yield levels reported by Solomon Brothers, and Standard and Poor's. Mr. Stasen also testified that bond traders look at a number of factors relevant to the market, including new issues and treasuries, to determine at which price to buy bonds. The formula used by Mr. Stasen to compute damages also assumes a twenty-year maturity bond with a seven and five-eights percent coupon rate, and a mark-up of $50 per bond (which Mr. Potvin testified was within the normal range of mark-ups charged by Hutton).

The defendants' expert, Mr. Farmer, testified, utilizing what is know as the "Bloomberg" system, that he found none of the plaintiff's bond prices to be unreasonable. He also testified that almost all major brokers now use the Bloomberg system to determine bond prices. Mr. Farmer's testimony, unfortunately, relying heavily on Bloomberg, shed no light on the amount of the spreads charged in this case.

15. At trial, Mr. Platsis testified that the Corporation suffered actual damages in addition to payment of undisclosed mark-ups, as follows: 1) Mr. Platsis testified that the Corporation lost a valuable client, Mr.

Pierce, due to the defendants' conduct and that he fears the Corporation will be sued for malpractice; and 2) Mr. Platsis testified that the "profitability" of the Corporation was adversely affected by the defendants' conduct. The Court find that the evidence does not support either of these conclusions.

Mr Platsis presumed to act as an investment adviser to Mr. Pierce, and made identical investments for Mr. Pierce based upon Mr. Potvin's recommendations. Mr. Potvin was aware that Mr. Platsis was making investment decisions for Mr. Pierce, and was in fact instructed by Mr. Platsis not to contact Mr. Pierce directly. Upon discovering that Mr. Potvin had made an investment for Mr. Pierce without Mr. Platsis' knowledge, Mr. Platsis informed Mr. Pierce that he could no longer serve as his attorney or investment adviser. These facts do not suggest that any conduct of the defendants caused the Corporation to lose Mr. Pierce as a client. Mr. Potvin continues to serve as Mr. Pierce' broker.

Regarding the claim of damage to the profitability of the Corporation, Mr. Platsis testified that the individual "losses" he suffered adversely affected his ability to supply his services to the Corporation, as well as his ability to contribute capital to the Corporation for funding of client contingency cases. No evidence was presented as to the profitability of the Corporation either before or after the events in question; no evidence was presented showing that specific clients were turned away due to a lack of capital; and no evidence was presented showing that the Corporation lost prestige or goodwill due to the conduct of the defendants. Inasmuch as no specific factual testimony was presented in support of these sweeping allegations, the Court finds no need to address the issue of whether such damages may be awarded as a matter of law.

16. Notably, Mr. Platsis' gains were taxed at capital gains rates as predicted by Mr. Potvin.

17. Although Mr. Platsis testified that his margin costs consumed virtually all of the bond income, no evidence was produced at trial showing that the Corporation (as opposed to Mr. Platsis personally) ever incurred margin costs.

18. Any conclusion of law containing findings of fact shall be considered as such.

19. A "market maker" was defined in 1980 as a dealer who, with respect to a particular security, holds himself out (by entering indications of interest in purchasing and selling in an inter-dealer quotations system or otherwise) as being willing to buy and sell for his own account on a continuous basis otherwise than on a national securities exchange.

Former Securities and Exchange Commission Rule 17a-9(f)(1), 17 C.F.R. section 240.17a-9(f)(1) (1980).

20. While commissions for agency transactions remained constant, Hutton would sometimes increase production credits for inventory sales if it wished to "unload" certain bonds.

21. Mr. Potvin's failure to disclose that some of the plaintiff's bonds were not highly liquid was not material. Mr. Platsis told Mr. Potvin that the Corporation would be transferring the bonds to Mr. Platsis in his individual capacity. Mr. Platsis desired his returns to be taxed at capital gains rates, which would require him to hold the

bonds for a minimum of six months. The Corporation's investment was thus not designed to be one in which it was important to be able to trade the bonds on a daily basis. In addition, there is no evidence that the Corporation was unable to transfer the bonds when it desired to.

22. Under different circumstances, the disclosure of market maker status alone might have been sufficient for 10b-5 purposes. See Simon v Merrill Lynch, Pierce, Fenner and Smith, Inc., 482 F.2d 880, 885 (5th Cir. 1983) (disclosure of market maker status by wire flash one month after purchase adequate); Pross v Baird Patrick & Co., Inc., 585 F. Supp. 1456, 1459 (S.D.N.Y. 1984) (disclosure of market maker status on confirmation slips and monthly statements adequate).

Current SEC rules require the disclosure of the trade price, the price charged to the customer, and the difference, if any, between these two prices. Rule 10b-10, 17 C.F.R. section 240.10b-10. This particular disclosure requirement did not go into effect until 1986. The transaction in this case occurred in 1980. The Court's decision is based upon its finding that the mark-ups were material in the context of the particular transactions undertaken by the plaintiff. See Ettinger v Merrill Lynch, Pierce, Fenner and Smith, 835 F.2d 1031, 1035-6 (3d Cir. 1987) (compliance with Rule 10b-10 disclosure requirements does not, as a matter of law, shield broker from liability under Rule 10b-5); Krome, 637 F. Supp. at 916 (a broker, "as an issuer of securities, has a duty to disclose information to purchasers of the securities independent of Rule 10b-10").

23. The Court is mindful that the plaintiff has not plead an unsuitability claim. Indeed, there is no evidence that treasury

securities were a suitable investment for the plaintiff.

24. With the exception of two omissions--the failure to disclose spreads or mark-ups and production credits--the Court cannot conclude that the plaintiff was misled in entering into its investment.

The remainder of the omissions and misrepresentations alleged by the plaintiff--with the exception of those referred to in the paragraph above--involve facts which were 1) not alleged in the third amended complaint (such as unsuitability), 2) disclosed to Mr. Platsis before the completion of the transactions (such as the bond issuers, prices, coupon rates, maturity dates, ratings, and yields to maturity), 3) publicly available to him (see, e.g., Plaintiff's Ex/65--Wall Street Journal; Defendants' Ex. B--Standard and Poor's Bond Guide), or 4) not material.

A breach of fiduciary duty may, if accompanied by deception, constitute a violation of Rule 10b-5. Santa Fe Industries, Inc. v Greens, 430 U.S. 462, 473-74 (1977). The plaintiff alleges that Mr. Potvin intentionally delayed the bond purchases in order to conceal markups. Mr. Potvin began executing purchases as soon as he was instructed to do so, on December 19, 1980. Mr. Platsis did not instruct Mr. Potvin to purchase all of the bonds in a single day, and there is no evidence that it would have been wise or even possible to do so. Thus, the Court finds that Mr. Potvin did not intentionally or recklessly delay the purchases.

The plaintiff further claims that its purchases were not executed at the highest yields available or at the "best" prices available. This allegation is nothing more than a claim of breach of fiduciary duty which, in itself, does not constitute a violation of Rule 10b-5. Notably, the

plaintiff received confirmation slips detailing its purchases, and could have at that time determined, using public information admitted into evidence at trial (such as the Wall Street Journal) whether higher yielding bonds or "better" prices were available.

25. Both the amount of production credits and the amount of spreads or mark-ups were material in this case. However, because the evidence showed that the production credits were included within the spreads, the amount of the production credits will not be added to the plaintiff's damages representing undisclosed spreads.

26. This $112,000 figure, according to the plaintiff, represents the amount the Corporation would have saved had a "proper investment" been made in municipal bonds. In other words, the Corporation could have received the same returns received on the utility bonds by instead spending $112,000 less to purchase municipal bonds.

27. An unsuitability claim is an allegation that a broker knowingly or intentionally chose unsuitable investments for the client. Leone v Advest, Inc., 624 F. Supp. 297, 304 (S.D.N.Y. 1985)

28. The plaintiff has requested an award of damages totalling $145,800, which includes pre-filing interest in the amount of 16 percent compounded annually over a nine-year period. The Court believes that awarding the full amount requested would be duplicative in part with the award of pre-judgment interest awarded by the Court, inasmuch as the $145,800 amount appears to include interest from December, 1980 to the time of trial.

29. In addition, it appears that two of the

discovery requests which instigated the defendants' motion for sanctions were directed to George Platsis in his individual capacity, even though Mr. Platsis had earlier been dismissed from the action and was no longer a party to whom interrogatories and requests for production could be directed.